

CITIZENS FINANCIAL GROUP, INC., MICHAEL SOCCIO

Proposal and Comment Information

Title: Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement, R-1866

Comment ID: FR-2025-0026-01-C15

Submitter Information

Organization Name: Citizens Financial Group, Inc.

Organization Type: Company

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Attached please find the comment letter on behalf of Citizens Financial Group, Inc. for Docket R-1886, RIN 7100-AG92 - Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement.

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June 23, 2025

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

RE: Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement
(Docket R-1866 and RIN 7100-AG92)

Dear Ms. Misback:

Background

On April 17, 2025, the Federal Reserve Board (FRB) published a Notice for Proposed Rulemaking (NPR) outlining an approach to reduce volatility in capital requirements associated with the Stress Capital Buffer (SCB) calculated from its supervisory run stress tests. While the NPR specifically outlines its proposed approach to average SCBs for banks participating in two consecutive stress testing cycles, the NPR also requests response on several questions pertaining to the broader stress testing framework.

The proposed SCB averaging would have very limited applicability to Category IV banks given their required participation in the stress test only every other year (with an option available to participate in off-cycle years). As a result, our comments in this letter are focused on the FRB stress test model itself as it is the primary driver of the volatility in SCBs and the inconsistency in results across banks over time. As such, this letter highlights key weaknesses in the FRB's pre-provision net revenue (PPNR) and credit modeling.

In addition to the concerns and suggestions we provide herein, Citizens contributed to the development of the comment letter submitted by the Bank Policy Institute (BPI). The BPI letter contains numerous desirable improvements to the stress testing process that we support. Below we highlight three issues described in the BPI letter that, if resolved in combination with our other suggestions for modeling changes found in the remainder of this document, would meaningfully enhance the overall stress testing framework:

- The FRB should provide full transparency into their stress testing models. This would allow for public feedback on the model to help enhance the accuracy of the results, ultimately reducing volatility.
- The FRB should establish a defined set of quantitative guidelines for all components of the supervisory stress test scenarios properly calibrated to the expected impact on capital levels. These guidelines should be publicly disclosed and subject to notice and comment, enhancing transparency in the process.
- The FRB should eliminate the dividend add-on given that payout restrictions under a breach of the SCB would prevent firms from distributing capital under stress. Therefore, it is unnecessary to require pre-capitalization of four quarters of dividends that won't be paid to shareholders.

Modeling weaknesses

Over the years, the FRB has received feedback from banks to help improve their models. However, given the limited visibility into the FRB's modeling, banks have had difficulty specifically identifying the underlying model weaknesses. We are looking forward to better understanding the models and providing clearer feedback to help enhance the framework more proactively, which ultimately would support a process that produces accurate capital requirements that are better aligned to the risk profile of each bank. Our points below summarize the PPNR and credit related issues we've communicated in the past.

Pre-provision net revenue

With respect to PPNR, we have had longstanding concerns that have been communicated to the FRB through various methods over a multi-year period, including a formal reconsideration request appended with informal presentations and discussions outlining our concerns. We have communicated issues related to:

- Improperly capturing the actual interest rate risk position for banks
- Unrealistic volatility in noninterest income and use of static backward-looking inputs to project mortgage, capital market, and service fee revenue streams.
- Inaccurately assuming that one-time costs, including those related to acquisitions, large identifiable strategic investments, and divestitures would impact expenses in the future.

As such, we outline our concerns with each of these matters in more detail below.

Interest rate risk hedges: *The FRB does not collect sufficient data to calculate existing swap net interest income (NII), nor does it collect any data on forward starting swaps that would become active during the measurement horizon.*

First, with respect to the **interest rate risk position** of banks, the FRB has noted in their 2025 Supervisory Stress Test Methodology document that their *"PPNR models incorporate historical net interest income trends to forecast post-stress revenues... model coefficients reflect the historical impact of hedging behavior on PPNR components."* The FRB goes on to say, *"[they] may explore collecting additional data to identify the impact of interest rate risk hedging at the start of the projection horizon on net interest income."*

Historical NII data does not provide reliable information regarding a bank's current interest rate risk position or expected NII in stress. This is because a backward-looking analysis of NII fails to account for changes in hedging strategy and derivative contract notional values expected to be outstanding over the forecast horizon relative to that of the historical measurement period. The current methodology employed by the FRB may have had immaterial impacts to capital requirements across the industry when both the actual level of interest rates and the rates projected under stress were both stable and near zero. However, this is no longer the case given the historic rise in short term rates along with recent significant and varied changes to banks' portfolio of interest rate hedges. Therefore, the FRB's approach misrepresents the interest rate risk exposure and expected NII performance of individual banks under the assumed stress scenario.

As a result, it is critical that the FRB (1) collect relevant interest rate hedge data within its existing FR Y-14 or FFIEC reporting, and (2) use a forward-looking approach to reflect the impacts of existing contracts to support an accurate calculation of individual bank's true rate risk under the specific scenario designed for its stress tests.

Noninterest income: *The FRB models do not have necessary granularity to accurately project the dynamics of key fee income components (such as mortgage fees and capital markets) in response to the assumed macroeconomic scenario.*

On **noninterest income**, according to the 2025 Supervisory Stress Test Methodology, the FRB models six sub-components of noninterest income. These sub-components include, *"trading revenue, fiduciary income and insurance and banking fees, investment banking fees, net servicing fees, service charges on deposits, and all other noninterest income."* The "all other" category uses a *"simple, nonparametric model... [and] are projected as the median of the firm's ratio over the most recent eight quarters... to allow for recent activity while also mitigating impact of volatility in any given quarter."*

This approach ignores the key dynamics for major fee categories, such as mortgage fees from origination activities and capital markets fees, which can have a counter-cyclical effect in a scenario of rapidly falling interest rates. In the case of mortgage fees, while stressed economic conditions would reduce home purchase activity, a low-interest rate environment, such as is typically projected under the supervisory severely adverse scenario, would drive additional refinance activity. This effect would protect noninterest income from falling as significantly under stress.

In addition, we would expect certain capital markets fees to continue generating fee income through a stress scenario. Particularly, foreign exchange and interest rate product fees would benefit under a falling rate environment as firms look to hedge exposures to a volatile market environment. In addition, lower valuations of commercial entities coupled with lower borrowing costs would attract M&A activity, while commercial debt refinancing opportunities would continue to exist under this environment as debt costs fall in line with the broader rate environment.

Also, the simplified approach utilized by the FRB for the “all other” fee category will impact banks differently. As is demonstrated in *Exhibit 1*, Category I firms only have on average, about 25% of their fee income in “all other”, whereas Category III and IV banks have more than half of their fee income in “all other”. As a result, Category III and IV banks are disproportionately affected by this simplified approach.

Exhibit 1:

Fee category as % of Total Fees (8 Qtr Median)						
Bank	Trading Revenue	Fiduciary Income & Insurance	IB Fees	Net Servicing Fees	Deposit Fees	All other
Category I Average	30%	23%	18%	1%	4%	24%
Category II & III Average	8%	14%	15%	2%	8%	53%
Category IV Average	2%	12%	6%	6%	15%	58%

To improve the accuracy of fee modeling, we recommend that the FRB narrow its focus historically to the periods most relevant to the scenario that the FRB has designed. In addition, given the complexity of projecting noninterest income across the diverse set of business mix across the industry, the FRB should determine a reasonable approach that can fairly assess the noninterest income generation capabilities for each bank, which may include more granular modeling within the “all other” category.

Noninterest expense: *The FRB models noninterest expense relative to total assets which can be impacted by changes to levels of cash and securities that have no impact on operating expenses.*

Regarding **noninterest expense**, the FRB has noted improvements to their projections for total compensation to account for stress impacts of variable compensation and commissions. However, other noninterest expense components are still based on their relationship to total assets. The current approach to modeling noninterest expenses would imply a potentially significant increase in operating costs as cash / securities balances grow, contrary to banks' actual experience whereby cash has no impact on expense levels whatsoever.

We ask the FRB to explore an alternative methodology not anchored to total assets, such as a percentage change from the most recent actual results, or another forward-looking approach that takes into consideration the typical reduction of discretionary spending that occurs in a stress scenario.

One-time expenses: *While the FRB does collect some data for one-time expenses (goodwill impairment, etc.), it does not account for certain identifiable one-time expenses (e.g., acquisition costs) unless it exceeds their predefined threshold of 7% of other non-interest expenses.*

The FRB models are likely to capture one-time costs from bank acquisitions along with significant investments in identifiable strategic initiatives without accounting for synergies, future revenue from these investments, or the ability to defer or reduce costs associated with these investments under stress. Internal bank modeling for expenses offers a much more accurate representation of expense management throughout the stress horizon, as it would capture these nuanced dynamics, whereas the more backward-looking approach from the FRB models delivers likely inaccurate results.

To accurately project PPNR, we recommend the FRB models exclude one-time costs due to significant M&A, large identifiable strategic investments, and divestitures. To the extent that historical results of acquired firms are considered in PPNR projections for the acquiror, non-recurring costs of the acquired firm prior to acquisition such as balance sheet restructurings or goodwill impairments should also be excluded. The FRB should also collect specific information from the bank to account for synergies and other aspects that may inform the PPNR forecast.

Credit Modeling

Home Equity Lines of Credit (HELOC): *The FRB assumes credit lines would fully draw when they go into default which ignores banks' active credit line management practices.*

Regarding **HELOC** losses, the 2025 Supervisory Stress Test Methodology notes that, "... the Federal Reserve sets EAD to the higher of the UPB at the start of the projection horizon and the original credit limit." This effectively assumes that customers will draw their entire remaining unfunded balances prior to going into default. This is inconsistent with (a) the FRB's static balance sheet approach, (b) actual experience under stress, (c) the bank's ability to cancel or freeze draw activity for unconditionally cancellable credit lines, such as HELOCs. This also penalizes HELOCs with historically lower utilization rates by assuming the entire line amount would be drawn and defaulted on. These harsh assumptions imply higher risk on collateralized assets that would deter banks from further extending credit to households.

The FRB should correct its EAD assumption to 1) reflect losses only on the unpaid principal balance, or 2) develop a data driven approach based on historical industry experience to estimate utilization rates during periods of stress.

Commercial Real Estate (CRE): *The FRB model produces extremely volatile results and may not fully consider various aspects of the credit quality of the borrower.*

Loss results in the **CRE** portfolio have been extremely volatile over the years. The FRB's approach of including CMBS data to project losses may contribute to anomalies in the results. As per the 2025 Supervisory Stress Test Methodology, "the Federal Reserve models the probability that a loan defaults over a single quarter using a binomial logit regression model and estimates the model using data from the FR Y-14Q collection pooled with historical loan performance data on loans securitized in commercial mortgage-backed securities (CMBS)... Some of the key loan characteristics that affect projected losses include the loan type (i.e., income-producing or C&LD), the property type (e.g., multifamily, retail, hotel, office, and other), loan-to-value (LTV) ratio, loan size, and loan age and the proximity of the loan to maturity.

CMBS, by its nature, is a combination of many loans, usually spread among different credit risk tranches, packaged into securities designed to achieve a certain yield for the bond investors and designed to offload assets from the balance sheets of those seeking to securitize the loans. Bilateral and Shared National Credit loans adhere more directly to the credit risk appetite of the originator or participant, and while a certain acceptable yield relative to risk is important, it's a different motivational and business objective than a bank or other creditor who seeks to originate to securitize. Moreover, the largest banks (JPM, Goldman, Morgan Stanley) are the primary originators of loans for CMBS.

Additionally, banks can be more flexible in providing loan extensions and renegotiating loan agreements with customers to mitigate default risk, whereas CMBS servicers are more contractually constrained than banks. Furthermore, in case of a default, banks can extend loans to support the deal rather than move to liquidation that could exacerbate losses as they have better access to information about the collateral value, management, and the impacts of the local economy. As a result, historical CMBS data has the potential to be a poor predictor of the magnitude of a given bank's CRE loss rates under stress.

We recommend the FRB perform back testing not only on the CMBS data but also on the historical loss data for individual banks to better account for differences in the credit characteristics of loans originated to securitize, of which the primary originators are the largest banks (e.g., JP Morgan, Goldman Sachs, Morgan Stanley) versus loans originated by regional banks. In addition, we suggest the FRB include other loan characteristics that may be critical to projecting more accurate stress losses for the CRE portfolio (e.g., the credit quality of sponsors and long-term tenants).

Allowance for Credit Losses: *The FRB results are inconsistent year-over-year, and they do not provide sufficient transparency of reserve requirements to understand the drivers.*

The FRB models **allowance for credit losses (ACL)** based on the estimated losses over the four quarters following the nine-quarter loss projection period. Therefore, at the end of the nine-quarter horizon, the ACL would reflect losses from projected quarter (PQ) 10 through 13. However, the FRB's results have reflected inconsistency in its ACL estimate at the end of the horizon as compared to the nine-quarter loss projections. There is additional inconsistency when comparing ending ACL and loss rates across banks, as banks with lower losses within the nine-quarter horizon may have higher ending ACL estimates, and vice versa. While the result of the ACL models and losses from PQ10 to PQ13 are equally important to the SCB, there is much less transparency for this component as compared to the losses estimated within the nine-quarter horizon. The opacity in the FRB's disclosures further limits our ability to understand drivers of the ACL at the end of the projection horizon.

As such, we request the FRB provide portfolio level ACL, or provision results, in its disclosures and provide additional transparency with respect to its results and modeling approaches. Also, the FRB should calibrate its allowance needed to cover the four quarters of expected loan losses after the nine-quarter horizon to be consistent with losses modeled within the nine-quarter window.

Summary

As discussed above, while some aspects of the NPR might provide some limited reduction in volatility for Category I through III banks, we believe there is an underlying volatility in bank capital requirements that is driven by the inherent weaknesses in modeling approaches used for key line items. Fixing these underlying issues as summarized below is essential to achieving the stated objectives of the NPR.

We recommend the FRB consider addressing the root causes of SCB volatility by:

- Collecting sufficient data to properly calculate NII associated with banks' active and forward starting **interest rate risk hedges** at the as of date of the stress test.
- Improving its modeling for more granular components of **noninterest income**, such as mortgage and capital markets fees.
- Decouple the modeling of **noninterest expense** from total assets and identify an alternative approach that is forward-looking and more representative of the variable nature of noninterest expenses.
- Incorporating adjustments for **one-time expenses** associated with mergers, large strategic investments, and divestitures.
- Accounting for banks' credit line management practices for **HELOCs** and only assuming losses would occur on unpaid balances, rather than assuming customers would fully draw on existing lines prior to default.
- Considering historical **commercial real estate** loss experience of individual bank loans by back testing its models on the historical loss data for individual banks rather than relying solely on CMBS data, and including the credit quality of sponsors and long-term tenants in modeling parameters.
- Provide transparency to PQ10 through PQ13 loss projections and calibrating the **allowance for credit losses** at the end of the horizon to losses modeled within the nine-quarter window.

We are encouraged by the recent actions and attention the FRB has taken to address the very important and material issues that drive meaningful changes in capital requirements over time and across individual banks. However, there are significant weaknesses in the stress test results that the FRB should address to enhance the accuracy of its results and reduce volatility of capital requirements. We are optimistic that the FRB will address the concerns outlined in comment letters submitted by the individual stakeholders and participating banks which will be essential to achieving its stated goal of reducing volatility.

We appreciate the opportunity to comment on this request and welcome further dialogue on this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "M. Soccio". The signature is stylized with a large, loopy initial "M" and a cursive "Soccio".

Michael J. Soccio
Executive Vice President and Treasurer
Citizens Financial Group, Inc.